**City of Mesa**
**Deferred Compensation Committee**
**MEETING MINUTES**
**Monday, August 4, 2014, 11:30am**
**Mesa City Plaza, Suite 130**
**Personnel Conference Room 2**

**Members Present:**
Mike Kennington (Chair)
Don Miller
Frank Hoglund
Kimberly Call
Mary Dellai
Michele Long

**Members Absent:**
Derek Witting
Michael Claspell
Vicki Eden

**Innovest:**
Gordon Tewell
Jerry Huggins

**Great West:**
Scott Taylor

**Other(s):**
Bill Taebel
Nikki Rosales

**Meeting called to order at 11:30am by Mike Kennington**

1. **Approval of the May 5 and June 5, 2014 minutes**
   Frank motioned to approve the minutes
   Mike seconded the motion
   None opposed

2. **InnoVault**
   Gordon presented InnoVault, which is a secure website that Innovest will use to store documents, such as quarterly reports, the IPS, newsletters, etc. This will eliminate large documents being sent through e-mail and will provide the committee members access to various documents. Innovest will work with our staff to set up access to InnoVault.

3. **Innovest Quarterly Update**

   The Markets
   The second quarter returns ended with emerging markets up at 6.60% and S&P 500 at 5.23%. Emerging markets still have room for growth, and U.S. stocks have had solid gains. The international market was at 4.09%. Bonds were at 2.05% and small cap stocks were at 2.04%.

   Headwinds/Tailwinds
   The U.S. Federal Reserve is doing away with quantitative easing. Europe is reluctant to engage in quantitative easing, even as they face deflation. England is doing well, but the rest of the country is struggling. Economic growth in the U.S. is still iffy. Reports indicate consumer confidence is high and lending is improving, but would still like to see some wage growth.

Quarterly Market Summary
Emerging markets and emerging market bonds led the way, along with U.S. real estate and U.S. stocks. In the U.S. sector, energy and utility stocks had a great quarter. It has been a great environment for low quality companies, but that will change at some point. In the bond market, government bonds lagged, whereas corporate and mortgage bonds were positive, with emerging markets leading the way.

Annual Fee Review
The fee review showed plan assets as of 6/30/13, but will be update at the next meeting. Innovest provided a document from Ann Schleck & Co., comparing plan document consultant fees. In relation to plans our size, 93% of plans are currently paying more for their consulting than we are.

Asset Allocation
Total plan assets grew from about $161 million to $165 million. There was some minor movement on the mid cap and international sides, but the most movement was in the brokerage window. The brokerage window increase from $8 million at the end of the 1st quarter to $9.5 million at the end of the 2nd quarter.

Table of Returns
There was overall had good performance from all managers, with the exception of two funds that had negative returns for the quarter. Most large cap equity managers performed at or above their peer groups, but some underperformed their index. Underperformes were mainly linked to being underweight in Apple, which makes up 6% of the total index. Fidelity Contrafund was the only large cap that underperformed their peer group. Mid cap equities struggled against both benchmark and peer groups. Artisan Mid Cap had a negative return when the index was up almost 4.5%. Its underperformance came from holdings in healthcare and technology. Small cap equities had good performance, with the exception of Kalmar Growth-with-Value fund, which had a negative return. International funds performed well, yet American Funds EuroPacific lagged for the quarter and the year, but ranked in the top 30% of international managers. Most of the underperformance was due to the fund being underweight in Japan and the UK. In global equity, Oppenheimer Global was underweight in U.S. equities and underperformed the benchmark. DFA Emerging Markets is not part of the plan yet, but it performed above the benchmark for the quarter, as well as the year. PIMCO outperformed the benchmark this quarter for fixed income. Voya ranked in the 11th percentile and outperformed the benchmark for the quarter in global real estate. The JPMorgan High Yield fund is right at the index for the quarter. The GW Stable Value fund was above the benchmark this quarter and ranks at median when compared to its peer group. All of the T. Row Price target date funds were in line or outperformed their indexes for the quarter. All T. Rowe Price vintages ranked in the top quartile, relative to their peers. Innovest pointed out that the detail pages for these plans have been modified to add more detail. The Department of Labor has put more emphasis on monitoring these target date funds, since their usage has gone up considerably. Innovest would like to provide a more detailed representation of these funds and what they look like in comparison to peers and what they look like in general. The model portfolios did not do quite as well as the target date funds, as the moderate and aggressive portfolios underperformed their benchmarks.

Manager Scorecard

| | Organization | People | Philosophy & Process | Style Consistency | Asset Base | Performance | Expense | Overall |
|---|---|---|---|---|---|---|---|---|
| Fidelity Contrafund | | | | | | | | |
| Aston: M&C Growth | | | | | | | | |
| Mainstay; Lg Cap Growth | | | | | | | | |
| Artisan: Mid Cap | | | | | | | | |
| J Hancock III | | | | | | | | |
| American Funds EuPc | | | | | | | | |
| Voya: Glbl RE | | | | | | | | |
| PIMCO Total Return | | | | | | | | |
| Mesa/GW Custom Stable Value | | | | | | | | |

*Minor concern*
*Major concern*

- **Aston: M&C Growth** – added an overall minor concern, because of the fund's performance. The current environment does not compliment this manager's strengths, but Innovest feels that this manager still has a place in our group of large cap funds.
- **Voya: Glbl RE** – name changed from ING to Voya

New Watch List

| **Watch List Criteria** | MainStay Large Cap | Aston Montag & Caldwell | J Hancock Disciplined Mid Cap | PIMCO Total Return | Voya Global Real Estate |
|---|---|---|---|---|---|
| *NUMBER OF QUARTERS ON THE WATCH LIST* | *5* | *4* | *3* | *2* | *5* |
| Changes in Ownership Structure or Material Litigation | | | | | |
| Investment Management Team Changes | | | | | |
| Significant Increase/Decrease in Assets Under Management | | | | | |
| Investment Style Stable/Consistent and Adherence to Investment Guidelines | | | | | |
| Performance In-Line with Expectations | | | | | |

*All shaded boxes indicate a FAIL in that criteria*

- **No changes** were made since last quarter, but two funds have been on the watch list now for 5 consecutive quarters, which requires formal action.
- **MainStay and Voya have both been on the watch list for 5 Quarters** – there are no major concerns at this time, but changes in ownership for both funds continue to be watched. Voya's recent performance has been good, but the 3 and 5-year numbers show it underperformed the benchmark and its peer group.  Innovest feels the performance of both funds is just a matter of the investing environment and does not recommend replacing either fund at this time, but suggests continuing to watch them.

**Formal Action:** Recommendation was made to keep MainStay and Voya on the watch list, with no changes at this time.

- Michele motioned to keep both funds on the watch list
- Don seconded the motion
- None opposed

**4. Review Updated Investment Policy Statement**

Most of the changes were administrative, with one big change to remove the Investment Guidelines for Stable Value Asset Fund from the IPS. Innovest worked with GW to pull that section from the IPS. One of the challenges was that Kathy, who manages the custom stable value fund, needed to sign the overall IPS, but was not in a position to do so, because she is not a fiduciary on the plan. It made more sense to remove it from the general IPS and have GW create guidelines for the custom stable value fund. A definition of the stable asset fund was added, in lieu of having the guidelines in the IPS. The signature page was updated to include the current committee members. In addition, Exhibit B added the Emerging Market fund and included changes to add DFA Emerging Markets to all three model portfolios.

**5. Review Great West Investment Guidelines**

There were two changes made to the investment guidelines. The current minimum Corporate and Non-Corporate Credit Bond rating is AA. At the last meeting, GW proposed changing it to BBB, but the committee did not want to go that low. The prosed minimum rating today is A+/A-. This will give the manager more flexibility, but retain high quality. The other change was under the No Competing Funds section, to modify the equity wash period from 180 days to 90 days, should an existing plan investment become a competing fund.

**6. Approval of Changes to the IPS and the Investment Guidelines for the Stable Asset Fund**

Frank motioned to approve the changes to the Investment Policy Statement and the Investment Guidelines for the Stable Asset Fund
Michele seconded the motion
None opposed

**7. Great West Quarterly Update**

<u>Second Quarter Update for 2014</u>

Plans assets are now at $162,185,702. The total number of plan participants is at 2,784. It was an unusual quarter, in regards to the cash flow. There were some significant distributions from the plan, which left the net cash flow at a negative balance, even though the contributions were the same. Payroll contributions were at $2,234,643 for the quarter, with incoming rollovers at $458,266. There were 57 full withdrawals taken, which is more than usual. Unforeseeable emergency withdrawals and death benefits claims increase as well. There were 19 firefighter recruits with money going into the city plan, but transferred to the fire plan.

Michele asked how emergency withdrawals are paid back. Scott indicated that participants cannot contribute to the plan for 6 months if they take an unforeseeable emergency withdrawal. If a loan is taken, the participant chooses the term for repayment, up to 5 years. It is paid back through the employee's paycheck, but the down side is that it is paid with after tax dollars. Therefore, when withdrawals are taken later, taxes will be paid again.

<u>NAGDCA Comparison</u>
The 2013 NAGDCA study included 89 governmental 457 plans. Scott did not have the exact number of employees eligible to contribute to the City plan, but calculated an estimate of 3170. That would put Mesa's participation rate at 62.15%, whereas the NAGDCA average is 23%. Mesa's average participant account balance is $56,739, whereas the average NAGDCA balance is $47,000. Mesa's average participant annual contribution dipped below the NAGDCA average at $4,052.

<u>Investment Advisory Services Usage</u>
The plan offers three levels of investment services: Guidance, Advice and Managed Accounts. There was not much change usage of the advice options, but managed accounts continue to increase. Six participants are using the advice option and 405 are using managed accounts.

<u>Local Education</u>
Scott was available a total of 32 days in Mesa. He held 29 group meetings, two educational seminars, 18 individual meetings and 3 new employee orientations.

8. **Upcoming Meetings**

   Next quarterly meeting will take place on November 3, 2014

9. **Meeting Adjourned at 12:40pm**